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IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

FOURTH APPELLATE DISTRICT

DIVISION THREE

SWH CORPORATION,

Plaintiff and Appellant,

v.

SELECT INSURANCE COMPANY,

Defendant and Respondent.

G036145

(Consol. with G036627)

(Super. Ct. No. 03CC12687)

O P I N I O N

Appeal from a judgment of the Superior Court of Orange County,  
Randell L. Wilkinson, Judge. Reversed and remanded.

Pillsbury Winthrop Shaw Pittman, Robert L. Wallan and Mariah L. Brandt  
for Plaintiff and Appellant.

London Fischer, Richard Stephen Endres and Scott P. Cranny for  
Defendant and Respondent.

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INTRODUCTION

This case presents the following issue: Does a directors and officers  
liability and private company indemnification insurance policy (the Policy) issued by

Select Insurance Company (Select) provide coverage for amounts paid by SWH Corporation (SWH) to settle a lawsuit brought by a class of current and former employees for alleged violations of California wage and hour laws?

The trial court concluded SWH's claim for the settlement payment fell within the Policy exclusion for certain statutory violations and granted summary judgment in Select's favor. Reviewing de novo, we conclude (1) SWH's claim fell within the Policy's definition of insurable loss, which includes "settlements" of employment claims; (2) there is a triable issue of fact whether the net settlement proceeds paid by SWH constitute a form of restitution that California law makes uninsurable; (3) the exclusion relied on by the trial court either does not exclude SWH's claim or is ambiguous; and (4) since there is a possibility of coverage, the trial court erred in summarily adjudicating SWH's claim for breach of the implied covenant of good faith and fair dealing in favor of Select. We therefore reverse and remand for further proceedings.

## FACTS

### I.

#### *The Policy*

SWH owns and operates a restaurant chain under the name Mimi's Café. Select issued the Policy naming Mimi's Café<sup>1</sup> as an "Individual Insured Company." The Policy period was March 1, 1999 through March 1, 2002.

The Policy covers "Claims" made during the Policy period for which the insured provides proper notice. The Policy provides that Select will pay any loss

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<sup>1</sup> Select issued the Policy to Saunders Karp Megrue Portfolio. At the time Select issued the Policy, Mimi's Café was participating in a large consortium of businesses (owned in whole or in part by Saunders Karp Megrue Portfolio) for the purpose of purchasing insurance.

incurred as the result of any claim for a wrongful act, up to \$27.5 million, with a retention for each claim.

The insuring clause in issue (Insuring Clause C) states in relevant part: “The Insurer will pay on behalf of the Insured Company, *Loss* which exceeds the Retention set forth in Item 4(b) of the Declarations up to the available maximum aggregate Limit of Liability . . . , and which Loss is incurred by the Insured Company as the result of any Securities Claim or *Employment Claim* first made against the Insured Company and reported in writing to the Insurer during the Policy Period . . . for a *Wrongful Act*.” (Italics added.) The terms in italics are defined below.

The Policy defines “Employment Claim” to mean “a Claim relating to any past, present or prospective Employee(s) of the Insured Company and alleging Wrongful Employment Practices by one or more Insureds.” The Policy defines “Wrongful Employment Practice” to include “(1) wrongful demotion, dismissal, discharge or termination (either actual or constructive) of employment; (2) employment related misrepresentation; (3) violation of employment laws; (4) sexual or workplace harassment of any kind; (5) employment discrimination; (6) wrongful failure to employ or promote; (7) wrongful discipline; [and] (8) wrongful deprivation of career opportunity including a wrongful failure to hire or promote . . . .” The Policy defines “Claim” to include “a written demand for monetary or non-monetary relief” and “a civil proceeding commenced by the service of a complaint or similar pleading.”

The Policy defines “Wrongful Act” to mean “any error, misstatement, misleading statement, act, omission, neglect, or breach of duty committed or attempted, or allegedly committed or attempted, by one or more Director Officer, individually or collectively, in their respective capacities as such or, with respect to Employment Claim or a Securities Claim only, an Employee, or with respect to Insuring Clause C or by the Insured Company, or any matter claimed against one or more Director(s) or Officer(s) solely by reason of their status as such.”

The Policy defines “Loss” to mean: “[T]he total amount which the Insured Person(s) become legally obligated to pay as the result of all Claims first made and reported during the Policy Period against any Insured Person(s), or with respect to Insuring Clause C and D only which the Insured Company becomes legally obligated to pay as the result of all Claims first made during the Policy Period against the Insured Company, for covered Wrongful Acts, including but not limited to damages, judgments, settlements, front pay awards, back pay awards, Defense Costs and/or punitive or exemplary damages or the multiple portion of any multiplied damage award if such damages are insurable under the law pursuant to which this policy is construed. . . . Loss does not include: (1) *Benefits* of the Insured Persons; . . . (6) matters uninsurable under the law pursuant to which this Policy is construed.” (Italics added.)

The Policy defines “Benefits” as “perquisites, fringe benefits, payments in connection with any pension, profit sharing stock incentive, health and welfare or other employee benefit plan or trust, and any other payment to or for the benefit of an employee arising out of the employment relationship.”

Paragraph 4.J. excludes from coverage claims for violations of nine categories of laws. Under paragraph 4.J., the insurer is not liable for payment for loss in connection with any claim “for an actual or alleged violation of, responsibilities, obligations or duties imposed by (1) any law governing workers’ compensation, unemployment insurance, social security, disability benefits or similar law, (2) the Fair Labor Standards Act (except the Equal Pay Act), (3) the National Labor Relations Act, (4) the Worker Adjustment and Retraining Notification Act, (5) the Consolidated Omnibus Budget Reconciliation Act of 1985, (6) the Occupational Safety and Health Act, (7) rules or regulations promulgated thereunder, amendments thereto or similar provisions of any federal, state or local statutory law or common law, (8) the Employee Retirement Income Security Act of 1974 or (9) any common law applicable to fiduciaries of any pension, profit sharing, health and welfare or other employee benefit plan or trust

established or maintained for the purpose of providing Benefits to employees of the Insured Company; however, this exclusion shall not apply to any Employment Claim for any actual or alleged Retaliatory Treatment.”

## II.

### *The Elzarie Action and SWH’s Claim Under the Policy*

The Elzarie Action was a putative class action lawsuit against SWH. The putative class consisted of current and former nonexempt SWH employees holding positions such as assistant manager at Mimi’s Café. The complaint alleged Mimi’s Café engaged in an unlawful practice of designating the class members as exempt employees to avoid paying them overtime wages in accordance with California wage and hour laws and regulations.

The complaint had six causes of action: (1) failure to pay overtime compensation in violation of California wage and hour laws; (2) failure to compensate for all hours worked in violation of California wage and hour laws; (3) failure to provide required meal and rest periods in violation of California wage and hour laws; (4) and (5) unfair business practices in violation of Business and Professions Code section 17200; and (6) failure to pay wages upon discharge in violation of Labor Code sections 201 and 203. The complaint sought damages, restitution, disgorgement of profits, punitive damages, interest, statutory penalties, and attorney fees. In September 2003, the Elzarie Action plaintiffs dismissed the second and third causes of action.

In November 2003, the parties to the Elzarie Action reached a settlement. In January 2004, the terms of the settlement were placed in a joint stipulation of settlement and release (the Joint Stipulation) between SWH and the Elzarie Action plaintiffs. The Joint Stipulation recites it is a complete settlement and release from “any and all wage claims” between the settling parties, “including but not limited to the wage

claims that were raised in the [Elzarie Action] related to the exempt or non-exempt status of Assistant Managers.”

Pursuant to the Joint Stipulation, SWH agreed to pay \$2.5 million into a settlement fund within five days after final court approval of the Joint Stipulation. In exchange, the class members agreed to release SWH from any and all wage claims, including the wage claims asserted in the Elzarie Action. After payments to the named plaintiff, the settlement administrator, and class counsel, the net amount of the settlement fund was \$1,941,608.43. That amount was to be distributed to class members who filed timely claims on a pro rata basis based upon the number of weeks each claiming class member had worked as an assistant manager for Mimi’s Café between October 29, 1997 and December 31, 2003. The Joint Stipulation states the payments to the class members “shall be categorized as ‘wages’ and shall be subject to the withholding of all applicable local, state and federal taxes.”

The trial court in the Elzarie Action gave final approval of the Joint Stipulation in August 2004. SWH incurred \$552,693.12 in costs in defending the Elzarie Action.

In January 2002, SWH claimed coverage under the Policy for the Elzarie Action and gave Select notice of the claim. Select denied coverage in June 2002, and in April and September 2003.

#### PROCEEDINGS IN THE TRIAL COURT

In October 2003, SWH filed this lawsuit against Select alleging breach of contract, breach of the implied covenant of good faith and fair dealing, and seeking declaratory relief based on Select’s denial of coverage under the Policy. On August 19, 2005, the trial court issued a minute order granting Select’s motion for summary judgment. The minute order stated in part: “The court finds that the moving party has met its burden of demonstrating that the plaintiff’s claims are excluded from the policy

. . . [.] The court finds that there is no coverage for plaintiff's obligation under the [Fair Labor Standards Act] or similar state laws."

On September 12, 2005, the trial court signed a formal order granting summary judgment. The order stated in part: "The Court finds that Select has met its burden of demonstrating that there is no coverage, under the insurance policy (the 'Policy') issued by Select to SWH, for the claims asserted against and settled by SWH in the underlying Elzarie action. The Court further finds that there is no coverage for SWH's obligations under the Fair Labor Standards Act and similar state statutes such as the California Labor Code Wage and Hour Laws which were at issue in the Elzarie action and settled by SWH." The trial court based its finding of no coverage on the exclusion of paragraph 4.J. alone and declined to address Select's other coverage arguments. The court concluded, "because there is no coverage under the Policy for the claims asserted against and settled by SWH, the cause of action against Select for breach of the covenant of good faith and fair dealing is without merit."

On October 4, 2005, SWH, having received no final judgment, filed a notice of appeal out of caution. That appeal bears docket No. G036145. A final judgment eventually was filed on December 20, 2005. SWH filed a notice of appeal from the final judgment on January 13, 2006. The second appeal bears docket No. G036627. The two appeals have been consolidated.

#### STANDARD OF REVIEW AND RULES OF INSURANCE POLICY INTERPRETATION

An insurer is entitled to summary judgment that no potential for indemnity exists if the evidence establishes no coverage under the policy as a matter of law. (*County of San Diego v. Ace Property & Casualty Ins. Co.* (2005) 37 Cal.4th 406, 414 (*Ace*)). Broadly speaking, "[i]f a party moving for summary judgment in any action . . . would prevail at trial without submission of any issue of material fact to a trier of fact for

determination, then he should prevail on summary judgment.” (*Aguilar v. Atlantic Richfield Co.* (2001) 25 Cal.4th 826, 855.)

““We apply a de novo standard of review to an order granting summary judgment when, on undisputed facts, the order is based on the interpretation or application of the terms of an insurance policy.”” (*Ace, supra*, 37 Cal.4th at p. 414; see also *Founding Members of the Newport Beach Country Club v. Newport Beach Country Club, Inc.* (2003) 109 Cal.App.4th 944, 955 [“When no extrinsic evidence is introduced, or when the competent extrinsic evidence is not in conflict, the appellate court independently construes the contract”].) However, “[w]hen the competent extrinsic evidence is in conflict, and thus requires resolution of credibility issues, any reasonable construction will be upheld if it is supported by substantial evidence.” (*Founding Members, supra*, 109 Cal.App.4th at p. 956.)

“Interpretation of an insurance policy is a question of law and follows the general rules of contract interpretation.” (*MacKinnon v. Truck Ins. Exchange* (2003) 31 Cal.4th 635, 647 (*MacKinnon*)). ““The fundamental rules of contract interpretation are based on the premise that the interpretation of a contract must give effect to the “mutual intention” of the parties. “Under statutory rules of contract interpretation, the mutual intention of the parties at the time the contract is formed governs interpretation. (Civ. Code, § 1636.) Such intent is to be inferred, if possible, solely from the written provisions of the contract. (*Id.*, § 1639.) The ‘clear and explicit’ meaning of these provisions, interpreted in their ‘ordinary and popular sense,’ unless ‘used by the parties in a technical sense or a special meaning is given to them by usage’ (*id.*, § 1644), controls judicial interpretation. (*Id.*, § 1638.)”” (*Id.* at pp. 647-648.)

An insurance policy provision is considered to be ambiguous when it is capable of at least two reasonable constructions. (*Ace, supra*, 37 Cal.4th at p. 415; *MacKinnon, supra*, 31 Cal.4th at p. 648.) ““But language in a contract must be interpreted as a whole, and in the circumstances of the case, and cannot be found to be

ambiguous in the abstract.” (*MacKinnon, supra*, 31 Cal.4th at p. 648.) “Courts will not strain to create an ambiguity where none exists.” (*Waller v. Truck Ins. Exchange, Inc.* (1995) 11 Cal.4th 1, 18-19.) “““If an asserted ambiguity is not eliminated by the language and context of the policy, courts then invoke the principle that ambiguities are generally construed against the party who caused the uncertainty to exist (i.e., the insurer) in order to protect the insured’s reasonable expectation of coverage.””” (*Ace, supra*, 37 Cal.4th at p. 415.)

An insurance policy’s coverage provisions must be interpreted broadly to afford the insured the greatest possible protection, while a policy’s exclusions must be interpreted narrowly against the insurer. (*MacKinnon, supra*, 31 Cal.4th at p. 648.) The exclusionary clause must be ““conspicuous, plain and clear.”” (*State Farm Mut. Auto. Ins. Co. v. Jacober* (1973) 10 Cal.3d 193, 202.) “This rule applies with particular force when the coverage portion of the insurance policy would lead an insured to reasonably expect coverage for the claim purportedly excluded.” (*MacKinnon, supra*, 31 Cal.4th at p. 648.)

The insured has the burden of establishing the claim comes within the scope of coverage, and the insurer has the burden of establishing the claim comes within an exclusion. (*MacKinnon, supra*, 31 Cal.4th at p. 648.) To prevail, the insurer must establish its interpretation of the policy is the only reasonable one. (*Id.* at p. 655.) Even if the insurer’s interpretation is reasonable, the court must interpret the policy in the insured’s favor if any other reasonable interpretation would permit coverage for the claim. (*Ibid.*)

## ANALYSIS

### I.

#### *SWH Incurred a Loss Resulting from an Employment Claim for a Wrongful Act Under the Policy's Insuring Clause C.*

##### *A. The Amounts SWH Paid to Settle the Elzarie Action Resulted from an Employment Claim for a Wrongful Act Under the Policy's Insuring Clause C.*

Insuring Clause C provides coverage for a Loss incurred by SWH resulting from an Employment Claim for a Wrongful Act. An Employment Claim means “a Claim relating to any past, present or prospective Employee(s) of the Insured Company and alleging Wrongful Employment Practices by one or more Insureds.” The Policy defines Wrongful Employment Practice to include “violation of employment laws.” A Claim includes “a civil proceeding commenced by the service of a complaint or similar pleading.”

The Elzarie Action was a civil proceeding commenced by the service of a complaint alleging Mimi's Café violated California employment laws (wage and hour laws) relating to SWH employees. The Elzarie Action therefore was an employment claim for a wrongful act within the meaning of Insuring Clause C.

##### *B. SWH Suffered a Loss as Defined by the Policy.*

###### *1. The Amounts SWH Paid to Settle the Elzarie Action Came Within the Policy's Definition of Loss.*

The Policy defines Loss to include “damages, judgments, settlements.”

The Elzarie Action, an Employment Claim under the Policy, was resolved by settlement. SWH's settlement payment pursuant to the Joint Stipulation was covered because it was a

“Loss . . . which the Insured Company bec[a]me[] legally obligated to pay as the result of . . . settlements.”<sup>2</sup>

Select argues the net settlement proceeds in the Elzarie Action are not a covered Loss because the Joint Stipulation characterized those proceeds as “wages,” which come within the definition of “Benefits of the Insured Persons.” Loss, as defined in the Policy, does not include Benefits of the Insured Persons.<sup>3</sup> For an Employment Claim, the Policy defines Insured Persons to include employees. SWH disputes that characterization of the net settlement proceeds and contends they are wages for tax purposes only.

Whether the net settlement proceeds were wages is, however, immaterial. Assuming the net settlement proceeds are wages,<sup>4</sup> we conclude those proceeds are a covered loss under the Policy.

The net settlement proceeds were paid as a settlement of a lawsuit of an Employment Claim. The proceeds therefore come within the definition of Loss. But if the settlement proceeds are characterized as wages, they might also be Benefits of the Insured Persons. The Policy states that Loss “does not include . . . Benefits of the Insured Persons.” Where, as here, the insured incurs a loss by paying money to settle a lawsuit

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<sup>2</sup> The amount SWH spent to defend the Elzarie Action was covered as “Defense Costs and/or punitive or exemplary damages or the multiple portion of any multiplied damage award.”

<sup>3</sup> The Policy defines Benefits as “perquisites, fringe benefits, payments in connection with any pension, profit sharing stock incentive, health and welfare or other employee benefit plan or trust, and any other payment to or for the benefit of an employee arising out of the employment relationship.”

<sup>4</sup> SWH contends the Joint Stipulation described the net settlement proceeds as wages for tax purposes only. This contention is based on the Joint Stipulation’s language, “[r]ead in context,” and the declaration of Randal Hughes, SWH’s vice-president of operations. In the declaration, Hughes stated, “[t]he settlement payment going to Elzarie Action class members in the settlement agreement was classified as ‘wages’ solely for tax purposes.”

alleging violations of employment laws, but the settlement proceeds are characterized as wages for employees, do the settlement proceeds come within the definition of Loss?

The issue is not the scope of an exclusion: Benefits of the Insured Persons are not an exclusion from coverage. Rather, the issue is how to reconcile two parts of the definition of Loss which are in conflict under the facts of this case. This conflict in the definition of Loss to include settlements alleging violations of employment laws, but not to include Benefits of the Insured Persons creates an ambiguity (see *Jordan v. Allstate Ins. Co.* (2004) 116 Cal.App.4th 1206, 1220 (*Jordan*)), which we resolve in SWH's favor. "When presented with such a conflict between competing policy provisions, it is our obligation to attempt to resolve the resulting ambiguity by first looking to the *objectively reasonable* expectations of . . . the insured." (*Ibid.*)

An ambiguity in an insurance policy "is resolved by interpreting the ambiguous provisions in the sense the promisor (i.e., the insurer) believed the promisee understood them at the time of formation." (*AIU Ins. Co. v. Superior Court* (1990) 51 Cal.3d 807, 822.) We generally resolve ambiguities in favor of coverage, and construe coverage provisions broadly. (*MacKinnon, supra*, 31 Cal.4th at p. 648; *AIU, supra*, 51 Cal.3d at p. 822.)

Reading the Policy as a whole, particularly the definition of Loss to include "settlements," we conclude SWH could objectively and reasonably believe the Policy afforded coverage for amounts paid in settlement of a lawsuit by current and former employees alleging violation of California wage and hour laws. The word "settlements," broadly construed, could include the amounts paid to settle the Elzarie Action, though characterized as wages, because those amounts constitute a *settlement* of an *Employment Claim*. The term Benefits of the Insured Persons (as used with respect to the definition of Loss in the Policy) does not include payments made in connection with "damages, judgments, settlements, front pay awards, [or] back pay awards." Otherwise, the exception of Benefits of the Insured Persons from the definition of Loss would eliminate

coverage for many kinds of settlements and judgments of employee claims, and would eliminate coverage *altogether* for back pay awards and front pay awards because those are necessarily payments to or for the benefit of employees.

The *Jordan* case is instructive. In *Jordan*, the insurance policy provided coverage due to “entire” collapse of a home caused by “hidden decay.” (*Jordan, supra*, 116 Cal.App.4th at p. 1209.) The policy contained an exclusion for any loss caused by “wet or dry rot.” (*Ibid.*) The insured made a claim under the policy for damage to her home caused by a water-conducting fungus. (*Id.* at p. 1210.) The insurer denied coverage based on the exclusion for wet or dry rot. (*Id.* at p. 1211.) The Court of Appeal, reversing summary judgment in favor of the insurer, concluded the use of the term “hidden decay” in the coverage provision and the use of the term “wet or dry rot” in the exclusion created an ambiguity with respect to coverage involving a claim of collapse. (*Id.* at p. 1219.) The ambiguity, the court explained, could be resolved in either of two ways: (1) collapse due to hidden decay would be covered, but not if such decay was caused by wet or dry rot; or (2) collapse due to hidden decay would be covered, but noncollapse damage caused by wet or dry rot was excluded. (*Ibid.*) While both interpretations were reasonable, the court resolved the ambiguity with the second interpretation because it was consistent with the insured’s objectively reasonable expectations. (*Id.* at p. 1220.)

Similarly here, the ambiguity created by the conflict between the definition of Loss to include “settlements,” but not to include Benefits of the Insured Persons, can be resolved in either of two ways: (1) settlement of an Employment Claim for violation of employment laws is covered unless the settlement involves payment to or for the benefit of employees; or (2) settlement of an Employment Claim for violation of employment laws is covered, but payment “to or for the benefit of an employee arising out of the employment relationship” that is not made in connection with “damages, judgments, settlements, front pay awards, [or] back pay awards” is not included within

the definition of Loss. We resolve the ambiguity by construing the Policy under the second interpretation because it is reasonable and is consistent with the insured's reasonable expectations, notwithstanding the reasonableness of the first interpretation. (*Jordan, supra*, 116 Cal.App.4th at pp. 1219-1220.)

Further, we construe the Policy in favor of coverage because Select drafted it and could have avoided the ambiguity. (*AIU, supra*, 51 Cal.3d at p. 822 [“Because the insurer writes the policy, it is held ‘responsible’ for ambiguous policy language, which is therefore construed in favor of coverage”].)

Select relies on a United States District Court case, *Big 5 Corp. v. Gulf Underwriters Ins. Co.* (C.D.Cal., July 14, 2003, No. CV02-3320WJR(SHX)) 2003 WL 22127029, in support of its contention the Policy does not cover amounts paid in settlement for unpaid wage claims. The insurance policy in that case covered losses resulting from an employment claim but specifically excluded indemnification of wages of former employees. (*Ibid.*) The district court concluded the settlement payments were made for unpaid wages and therefore were not a covered loss under the policy. (*Ibid.*) The *Big 5 Corp. v. Gulf Underwriters Ins. Co.* decision does not quote all of the relevant policy provisions, and, therefore, does not reveal whether, as in this case, the policy defined “loss” to include payments made in settlement of employment claims or whether the exclusion of indemnification for wages created an ambiguity in the policy.

Our construction of the Policy is consistent with the apparent purpose for excepting Benefits of the Insured Persons from the definition of Loss. That purpose was not to preclude coverage for settlements and judgments arising out of employee wage and hour claims. The definition of Loss includes settlements and judgments. The purpose for not including Benefits of the Insured Persons in the definition of Loss, it seems, was to avoid insuring SWH's payroll and employee benefit expenses.

2. The Net Settlement Proceeds Come Within the Meaning of the Term “Back Pay Awards.”

SWH argues the net settlement proceeds are a covered loss because they constitute “back pay awards,” which come within the definition of Loss under Insuring Clause C. We agree.

Select argues the term “back pay” has a specific, technical meaning referring only to the remedy for wrongful discrimination or termination—i.e., unearned wages. SWH argues back pay does not refer to claims for *earned* but unpaid wages, which was the case in the Elzarie Action. Thus, according to Select, “[t]he plain meaning of ‘back pay awards’ and ‘front pay awards’ in the context of employment practices coverage simply does not include ordinary (or overtime) wages earned by an employee and wrongfully withheld by an employer.”

Select cites a series of cases defining back pay (and front pay) as remedies for wrongful termination of or discrimination against an employee. (*Lowe v. California Resources Agency* (1991) 1 Cal.App.4th 1140, 1144, fn. 3 [“In the employment discrimination context, the term ‘[b]ack pay refers to the amount that plaintiff would have earned but for the employer’s unlawful conduct, minus the amount that plaintiff did earn or could have earned if he or she had mitigated the loss by seeking or securing other comparable employment”]; *Johnson v. Spencer Press of Maine, Inc.* (1st Cir. 2004) 364 F.3d 368, 379 [“An award of back pay compensates plaintiffs for lost wages and benefits between the time of the discharge and the trial court judgment”]; see also *Parker v. Twentieth Century-Fox Film Corp.* (1970) 3 Cal.3d 176, 181 [“The general rule is that the measure of recovery by a wrongfully discharged employee is the amount of salary agreed upon for the period of service, less the amount which the employer affirmatively proves the employee has earned or with reasonable effort might have earned from other employment”].)

Indeed, cases support Select's distinction between back pay for unearned wages and damages for earned but unpaid wages. (*Hoffman Plastic Compounds v. NLRB* (2002) 535 U.S. 137 [federal immigration law precludes award under the National Labor Relations Act of back pay for unperformed work to illegal immigrants whose employment was terminated for participating in union organization]; *Del Rey Tortilleria, Inc. v. NLRB* (7th Cir. 1992) 976 F.2d 1115, 1122, fn. 7 [recognizing illegal aliens could not recover back pay for unearned wages, but could maintain an action for unpaid wages under the Fair Labor Standards Act]; *Patel v. Quality Inn South* (11th Cir. 1988) 846 F.2d 700, 706 [illegal aliens may recover unpaid wages for work performed under the Fair Labor Standards Act]; *Rios v. Enterprise Assn. Steamfitters Local Union 638 of U.A.* (2d Cir. 1988) 860 F.2d 1168, 1173 [illegal aliens may recover back pay under title VII of the Civil Rights Act of 1964 (Title VII) if they were available to work during the period covered by the back pay].)

By using the term “back pay awards” rather than just “back pay,” the parties might have intended a more technical meaning apply to the Policy. Case law often uses the terms “backpay award” or “award of backpay” specifically to refer to a remedy issued exclusively by the National Labor Relations Board for violations of the National Labor Relations Act, or as a remedy under Title VII. As explained in *NLRB v. J. H. Rutter-Rex Mfg. Co.* (1969) 396 U.S. 258, 263: “The legitimacy of back pay as a remedy for unlawful discharge or unlawful failure to reinstate is beyond dispute, [citation], and the purpose of the remedy is clear. ‘A back pay order is a reparation order designed to vindicate the public policy of the statute by making the employees whole for losses suffered on account of an unfair labor practice.’ [Citation.] As with the Board’s other remedies, the power to order back pay ‘is for the Board to wield, not for the courts.’ [Citation.]” (See also *Sure-Tan, Inc. v. NLRB* (1984) 467 U.S. 883, 898, 900 [National Labor Relations Board has statutory power to award “backpay” as “a means to restore the situation ‘as nearly as possible, to that which would have obtained but for the illegal

discrimination”]; *Albemarle Paper Co. v. Moody* (1975) 422 U.S. 405, 440 (conc. opn. of Marshall, J.) [back pay available as remedy under Title VII for failure to promote based on race]; *Johnson v. Spencer Press of Maine, Inc.*, *supra*, 364 F.3d at p. 379 [“Both back pay and front pay are authorized by [Title VII]”]; *Rivera v. NIBCO, Inc.* (9th Cir. 2004) 364 F.3d 1057, 1067 [“Title VII’s enforcement regime includes . . . traditional remedies for employment law violations, such as backpay, frontpay, and reinstatement”].)

In addition, various statutory schemes use the terms “backpay” or “backpay award” to mean a remedy for wrongful discrimination or termination, i.e., unearned wages. (See Unemp. Ins. Code, § 1382; Lab. Code, §§ 1062, 1073; Ins. Code, § 1871.7, subd. (k); Gov. Code, §§ 19702, subd. (d)(1), 19683, subd. (c); Health & Saf. Code, § 1596.882, subd. (d); Pub. Util. Code, § 99561.3.)

As SWH argues, words and terms used in an insurance policy should be interpreted in their “ordinary and popular sense” unless the parties intended a technical meaning or special usage. (Civ. Code, § 1644; *AIU*, *supra*, 51 Cal.3d at pp. 821-822.) “[B]ack pay awards” is not a defined term in the Policy. It places the term “back pay awards” in the list of types of legal recovery, defining Loss to include “damages, judgments, settlements, front pay awards, back pay awards, Defense costs and/or punitive or exemplary damages or the multiple portion of any multiplied damage award.” That would suggest the parties intended “back pay awards” to refer to such awards issued by the National Labor Relations Board or a similar body, which might not otherwise come within the meaning of judgments or damages. Such an interpretation would be nonsensical, however, because the Policy excludes loss resulting from “violation of, responsibilities, obligations or duties imposed by . . . the National Labor Relations Act.”

We conclude the Policy does not manifest an intent to use a technical or special meaning for the term “back pay,” which therefore should be interpreted in its ordinary and popular sense. We agree with SWH the ordinary and popular meaning of “back pay” is payment for work done in the past. For example, Webster’s Third New

International Dictionary (1993) page 157 gives the second definition of the adjective “back” as “overdue” or “in arrears” or “due for services performed prior to the latest pay period <a retroactive increase results in [back] wages for workers>.” This definition, though not binding, is useful (*MacKinnon, supra*, 31 Cal.4th at p. 649) and is consistent with what we perceive to be the ordinary and popular usage of the term “back pay.” We doubt a layperson reading the Policy would believe the term “back pay awards” refers only to unearned wages resulting from unlawful discrimination or termination in violation of the National Labor Relations Act, Title VII, or similar statutory law, and not to unpaid wages for work performed.

## II.

### *Whether SWH Suffered a Loss Constituting Restitution That Is Uninsurable Under California Law Is an Issue of Fact.*

The Policy defines Loss to exclude “matters uninsurable under the law pursuant to which this Policy is construed.” Select argues the amounts SWH paid to settle the Elzarie Action are not covered because they constitute restitution that is uninsurable under California law.

The Joint Stipulation does not describe the net settlement proceeds except to label them as wages. The Elzarie Action alleged violations of California wage and hour laws and of the California unfair competition law, Business and Professions Code section 17200 et seq. (the UCL). The complaint sought damages, restitution, disgorgement of profits, punitive damages, statutory penalties, and attorney fees. The complaint sought recovery of unpaid overtime wages under Labor Code section 1194, subdivision (a).

Whether recovery under Labor Code section 1194, subdivision (a) constitutes damages or restitution is unclear. The statute refers only to recovery.<sup>5</sup> Damages are intended to provide the victim monetary compensation for an injury to person, property, or reputation, while restitution is intended to return to the victim the specific money or property taken. (*Bowen v. Massachusetts* (1988) 487 U.S. 879, 893; see also *Aerojet-General Corp. v. Superior Court* (1989) 211 Cal.App.3d 216, 231 [“In its typical sense, restitution is the return of something wrongfully received”].) In *Cortez v. Purolator Air Filtration Products Co.* (2000) 23 Cal.4th 163, 178, the court concluded, “unlawfully withheld wages are property of the employee within the contemplation of the UCL . . . [and] may be the subject of a restitutionary order.”

The line between damages and restitution is often fine or invisible. (See *Inline, Inc. v. Apace Moving Systems, Inc.* (2005) 125 Cal.App.4th 895, 903 [“The distinction between damages and restitution can seem elusive”]; Rest.2d Torts, § 903 [defining “compensatory damages” to include damages awarded as restitution].) Where the line is drawn, or whether it should be drawn at all, often depends on the context in which recovery is sought. In the context of insurance coverage, the California Supreme Court has stated, “[w]hatever technical distinctions we and other courts have drawn between restitution and compensatory damages in other contexts, in ordinary terms both concepts are within the definition of ‘damages.’” (*AIU, supra*, 51 Cal.3d at p. 836.)

The California Supreme Court has recognized, “as a matter of public policy, an insured’s payment of *certain types* of restitution cannot be covered by insurance.” (*AIU, supra*, 51 Cal.3d at p. 836, italics added.) For example, in *State Farm*

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<sup>5</sup> Labor Code section 1194, subdivision (a) states: “Notwithstanding any agreement to work for a lesser wage, any employee receiving less than the legal minimum wage or the legal overtime compensation applicable to the employee *is entitled to recover in a civil action* the unpaid balance of the full amount of this minimum wage or overtime compensation, including interest thereon, reasonable attorney’s fees, and costs of suit.” (Italics added.)

*Fire & Cas. Co. v. Superior Court* (1987) 191 Cal.App.3d 74, the court held an insurer had no duty to defend the insured's criminal prosecution because restitution to crime victims is an uninsurable punitive remedy. In *Jaffe v. Cranford Ins. Co.* (1985) 168 Cal.App.3d 930, 935, the court held an insurer had no duty to defend the insured against charges of Medi-Cal fraud because any reimbursement would be restitution, and the policy limited coverage to damages. The *Jaffe* court expressed doubt whether an insurance policy purporting to insure against restitution payments would be consistent with public policy, "[a]t least absent demonstrably unusual circumstances." (*Ibid.*) In *Aerojet-General Corp. v. Superior Court, supra*, 211 Cal.App.3d 216, 231, the court concluded response costs incurred pursuant to the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) though arising from an equitable proceeding, "may not in effect be restitutionary." The court held the insurance policy, which covered damages, was therefore ambiguous as to such response costs and resolved the ambiguity against the insurer. (*Id.* at p. 232.)

In *AIU, supra*, 51 Cal.3d 807, 813-814, the court analyzed those cases and held a comprehensive general liability insurance policy provided coverage for cleanup and other response costs incurred pursuant to CERCLA. The court noted CERCLA "is a strict liability statute that serves essentially remedial goals, irrespective of fault." (*Id.* at p. 836.) Although response costs under CERCLA are "restitutive" in nature, the *AIU* court was "not persuaded that the relief at issue here is of the narrow type identified by these cases as not a proper subject of coverage by insurance." (*Id.* at pp. 836-837.)

The "narrow type" of uninsurable relief those cases identify is, we glean from the cases, restitution of property or money obtained by criminal, willful,<sup>6</sup> or fraudulent conduct, and/or restitution that is punitive in nature.

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<sup>6</sup> Insurance Code section 533 exonerates an insurer from "a loss caused by the wilful act of the insured."

Select failed to meet its initial burden of producing evidence showing the net settlement proceeds, if restitution, came within any of those descriptions of uninsurable relief. California's minimum wage and overtime laws are remedial, not punitive (*Sav-On Drug Stores, Inc. v. Superior Court* (2004) 34 Cal.4th 319, 340), and Labor Code section 1194 creates strict liability for paying overtime wages, irrespective of fault. Thus, a finding SWH was liable under Labor Code section 1194 and other California wage and hour laws would not necessarily mean SWH engaged in criminal, willful, or fraudulent conduct.

The Elzarie Action included two causes of action under the UCL. As explained above, in *Cortez v. Purolator Air Filtration Products Co.*, *supra*, 23 Cal.4th at pages 177-178, the court concluded an employee's recovery of unlawfully withheld wages is a restitutionary remedy authorized under the UCL.

In *Bank of the West v. Superior Court* (1992) 2 Cal.4th 1254, 1272, the California Supreme Court held insurance coverage for losses from "'advertising injury'" did not refer to conduct violating the UCL because it permits recovery only of restitution. The *Bank of the West* court did not, however, deem all forms of restitution to be uninsurable, and acknowledged "[w]e did hold in *AIU* that insurable 'damages' include monetary awards that represent compensation for harm to third parties, even if such awards bear the label 'restitution.'" (*Id.* at p. 1270.) Recovery of unpaid wages under the UCL is an alternate to recovery under Labor Code section 1194. (*Janik v. Rudy, Exelrod & Zieff* (2004) 119 Cal.App.4th 930, 942-943 ["'an action to recover wages that might be barred if brought pursuant to Labor Code section 1194 still may be pursued as a UCL action seeking restitution pursuant to [Business and Professions Code] section 17203 if the failure to pay constitutes a business practice'"].) Thus, if the settlement payment made by SWH constituted restitution of unpaid wages uninsurable under the UCL, the settlement payment nonetheless might also constitute an insurable form of recovery under another statute. The complaint in the Elzarie Action and the Joint Stipulation were

sufficient evidence on a summary judgment motion to demonstrate a triable issue of material fact on that issue.

In sum, we find a triable issue of material fact whether the amounts SWH paid to settle the Elzarie action, if deemed to be restitution, were uninsurable.

### III.

#### *SWH's Claim of Loss Does Not Come Within the Exclusions of the Policy's Paragraph 4.J.*

The trial court granted summary judgment on the ground SWH's claim of loss was excluded from coverage under paragraph 4.J. of the Policy. Paragraph 4.J. excludes any claim based on actual or alleged violations of nine categories of laws. The second category of such laws is the Fair Labor Standards Act, 29 United States Code section 201 et seq. (FLSA). The sixth category is the Occupational Safety and Health Act (OSHA). The seventh category is "rules or regulations promulgated thereunder, amendments thereto or similar provisions of any federal, state or local statutory law or common law."

Select asserts category seven modifies category two only, or modifies categories one through six. The California wage and hour laws are, Select argues, similar to the FLSA, which regulates the hours and wages of employees or enterprises engaged in commerce or the production of goods for commerce. Thus, Select argues, SWH's claims arising from the Elzarie Action are excluded from coverage under the Policy. The trial court agreed with this assertion, finding paragraph 4.J. to be "not ambiguous."

Select's interpretation is untenable. Each of categories one through six of laws identified in paragraph 4.J. stands on its own; none modifies a previous category. If the parties intended the state law modifier to modify all the previous categories of laws, they presumably would have placed category seven at the very end of the paragraph, or

would have explicitly identified the categories subject to the modification. The Policy did not do so.

We conclude paragraph 4.J. is ambiguous. That paragraph is not “‘conspicuous, plain and clear.’” (*State Farm Mut. Auto. Ins. Co. v. Jacober, supra*, 10 Cal.3d at p. 202.) We construe the exclusion against Select for three reasons. First, experience with and knowledge of the English language would lead an objectively reasonable insured to believe the state law modifier in category seven would modify only the immediately preceding category, OSHA violations. (See Strunk, Jr., & White, *The Elements of Style* (4th ed. 2000) p. 30 [“Modifiers should come, if possible, next to the words they modify”].) Thus, it would not make sense for category seven to modify only category two because those two categories are not next to each other. If category seven modified each of categories one through six, it would be redundant of category one, which already covers “any law” governing workers’ compensation, unemployment insurance, social security, or disability benefits.

Second, construing the exclusion of paragraph 4.J. narrowly (*MacKinnon, supra*, 31 Cal.4th at p. 648) leads to the conclusion category seven modifies only category six (OSHA violations). Finally, Select wrote the Policy and is held responsible for ambiguous policy language. (*AIU, supra*, 51 Cal.3d at p. 822.) Accordingly, if we were otherwise unable to resolve the ambiguity, we would construe it against Select. (*Ibid.*; see also *Ace, supra*, 37 Cal.4th at p. 415.)

Select missed the mark if it intended an unambiguous exclusion for wage and hour claims under California law. It would not have been difficult to clearly and plainly exclude such wage and hour claims, either through the exclusions or the definitions—if Select intended to do so.

IV.

*Summary Judgment of SWH's Cause of Action for Breach of the Implied Covenant of Good Faith and Fair Dealing Is Reversed.*

The trial court summarily adjudicated SWH's cause of action for breach of the implied covenant of good faith and fair dealing in Select's favor based on the conclusion the Policy did not cover SWH's claim. We reverse because SWH's claim was for a covered loss under the Policy and because we find a question of fact whether the net settlement proceeds constitute restitution that is uninsurable. Further, our review of the record leads us to conclude SWH met its burden in opposing summary judgment of establishing the existence of a triable issue of material fact whether Select acted reasonably in denying SWH's claim. (See Code Civ. Proc., § 437c, subd. (p)(2).)

DISPOSITION

The judgment is reversed and the matter is remanded. Appellant shall recover its costs incurred on appeal.

FYBEL, J.

WE CONCUR:

RYLAARSDAM, ACTING P. J.

ARONSON, J.